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Weekly Fixed Income Commentary

15 August 2022

Treasury yields remain flat as inflation softens

U.S. Treasury yields were broadly flat and spread assets outperformed following lower-than-expected inflation data. The yield curve ended the week even more deeply inverted.

HIGHLIGHTS

- **Total returns were positive for agencies, investment grade and high yield corporates, MBS, ABS, preferreds, convertibles, loans and emerging markets.**
- **Total returns were negative for Treasuries and taxable municipals.**
- **Municipal bond yields were essentially unchanged. New issue supply was $6.6B, with outflows of -$635M. This week's new issue supply should be $12.1B ($4B taxable).**

Anders Persson
CIO of Global Fixed Income

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Watchlist

- *10-year Treasury yields were flat; we expect them to remain volatile and move modestly higher this year.*
- *Spread assets benefited from softer inflation data.*
- *Net-negative supply should provide some support to municipal bonds.*

INVESTMENT VIEWS

Accommodative interest rate policy remains a key market support. While investors continue to focus on more hawkish Fed policy, overall rates are likely to remain relatively low even after several rate hikes.

The underlying growth outlook remains healthy, as consumers have strong balance sheets, businesses are reinvesting and Covid recedes. This should keep defaults low.

Treasury yields are likely to rise this year, but we don't expect the 10-year Treasury yield to rise much above 3.00%.

We favor a risk-on stance, focused on credits with durable free cash flow and solid balance sheets across a wide range of sectors. Mid-quality rating segments appear particularly attractive. Essential service municipal bonds also look compelling.

KEY RISKS

- Inflation fails to moderate as expected, negatively affecting asset values.
- Policymakers remove accommodation too rapidly, undermining the global economic expansion.
- The Russia/Ukraine conflict continues to escalate.
- COVID-19 cases increase, or new variants emerge.

HIGH YIELD CORPORATES SEE SIXTH STRAIGHT WEEKLY GAIN

U.S. Treasury yields ended the week close to flat, ultimately retracing a mid-week rally after the softer-than-expected July inflation numbers. Headline consumer prices were unexpectedly flat for the month, taking the year-over-year inflation rate to 8.5%, down from 9.1% in June. The 10-year yield traded flat for the week at 2.83%, while 2-year yields ended 2 basis points (bps) higher at 3.24%. Yields rose late in the week on positive risk sentiment, fully retracing a -20 bps rally from right after the CPI release. The moves sent the yield curve into deeper inversion.

Investment grade corporate prices gained, returning 0.60% for the week and outperforming similar-duration Treasuries by 57 bps. That took spreads -9 bps tighter to 132 bps for the index. Supply continued to be healthy at $30 billion. Inflows slowed sharply from the prior week's gain, but remained positive at $70 million.

High yield corporates outperformed again, gaining 0.95% and beating similar-duration Treasuries by 97 bps. That marked the sixth straight weekly gain, the longest such streak since early 2021. Overall yield levels are now down to 7.43%, almost -150 bps lower from the late June peak and down to the lowest level in two months. Lower-quality segments rallied more substantially, with CCC bonds gaining 1.77%. Senior loans, which are lower-quality in aggregate than high yield bonds, gained 1.17%, for their fifth straight weekly gain.

Emerging markets led the rally, gaining 1.06% and outperforming similar-duration Treasuries by 132 bps. High yield sovereigns gained 2.60% as spreads tightened -44 bps. The high yield sovereign index peaked with a spread of more than 1,000 bps last month, but is now -200 bps tighter. It helped that the dollar has stabilized after a strong rally this year, retreating -0.93% for the week, while commodity prices have also rebounded (4.5% for the week) after a recent selloff.

HIGH YIELD MUNICIPAL FUND FLOWS REMAIN POSITIVE

The municipal market ended last week essentially unchanged. Munis continue to be well bid, supply is muted and an outsized amount of reinvestment money remains on the sidelines, ready to be put to work.

The fixed income market overall has a good tone, mainly because inflation appears to be cooling. Last week the Consumer Price Index and the Producer Price Index showed lower inflation than in previous months. That being said, the Fed had maintained it will continue to raise rates until it is certain inflation is under control. Many Fed members spoke this week, saying they will continue to fight inflation. Fed member Kashkari stated, "The Fed is far away from declaring victory on inflation."

The city of Los Angeles, CA, issued $1.2 billion airport revenue bonds (rated Aa2/AA), including both AMT and non-AMT bonds. The deal was well received. The deal was upsized due to demand. Some bonds traded at a slight premium in the secondary market.

High yield municipal credit spreads and municipal-to-Treasury yield ratios were unchanged last week. High yield municipal flows remained positive, but at a reduced pace. We are tracking at least 14 new issue deals for this week, including a $290 million deal for U.S. Steel and a $785 million deal for Brightline Florida. The Brightline deal should be backed by future lease payments from Broward and Miami-Dade Counties for the right to build and operate a slower speed/multi-station commuter rail. The proceeds will be used to complete Phase 2 of the high speed rail line alongside an additional large equity contribution.

Senior loans saw their fifth straight weekly performance gain.

In focus

Energy helps inflation decline

Consumer prices decelerated in July, according to the latest data released last week. Headline inflation moderated from 9.1% to 8.5% year-over-year. This is unequivocally positive news, but does not materially change our outlook for inflation, monetary policy or markets moving forward.

We continue to expect the Fed to hike rates 50 bps next month, followed by additional 25 bps hikes in November and December. We believe risks are skewed toward the Fed doing more tightening than currently priced in, rather than less.

Most of the improvement in the July inflation numbers was from energy prices, which fell -4.6% for the month. The core index, which excludes volatile food and energy, still showed positive inflation of 0.3% month-over-month. Even that number was dragged down -8 bps due to lower airline fares, which are usually affected by oil prices. The less volatile and stickier elements of inflation continue to be worrying. In particular, shelter prices, which include housing and rental costs, are still running at an annualized rate of 6% to 7%.

We continue to expect headline inflation to moderate moving forward, and believe that June marked the peak in year-over-year inflation rates. This moderation should be enough for the Fed to downsize the magnitude of the next few interest rate hikes. We still think that rates are too low at current levels, and see modest further upside in long-end interest rates this year. We forecast the 10-year Treasury yield to end the year around 3.00%.

U.S. Treasury market

		Change (%)		
Maturity	Yield	Week	Month-to-date	Year-to-date
2-year	3.25	0.02	0.36	2.51
5-year	2.96	0.00	0.28	1.69
10-year	2.83	0.00	0.18	1.32
30-year	3.11	0.04	0.10	1.21

Source: Bloomberg L.P., 12 Aug 2022. **Past performance does not predict or guarantee future results.**

Municipal market

		Change (%)		
Maturity	Yield to Worst	Week	Month-to-date	Year-to-date
2-year	1.75	0.06	0.15	1.51
5-year	1.82	0.00	0.02	1.23
10-year	2.24	0.00	0.03	1.21
30-year	2.93	0.02	0.04	1.44

Source: Bloomberg L.P., 12 Aug 2022. **Past performance does not predict or guarantee future results.**

Yield ratios

	Ratio (%)
10-year AAA Municipal vs Treasury	79
30-year AAA Municipal vs Treasury	96
High Yield Municipal vs High Yield Corporate	68

Source: Bloomberg L.P., Thompson Reuters, 12 Aug 2022. AAA municipals represented by the MMD scale. The high yield ratio equals the yield-to-worst for the Bloomberg High Yield Municipal Index divided by the yield-to-worst for the Bloomberg High Yield Corporate Index. **Past performance does not predict or guarantee future results.**

Characteristics and returns

				Returns (%)		
Index	Yield to Worst (%)	Spread (bps)	Effective Duration (years)	Week	Month-to-date	Year-to-date
Municipal	2.87	–	6.64	-0.08	-0.19	-6.76
High yield municipal	5.04	225[1]	10.08	-0.04	-0.11	-8.57
Short duration high yield municipal[2]	4.57	252	4.19	-0.08	-0.07	-3.59
Taxable municipal	4.31	124[3]	9.37	-0.25	-1.31	-13.46
U.S. aggregate bond	3.62	46[3]	6.44	0.24	-0.80	-8.89
U.S. Treasury	3.13	–	6.53	-0.09	-0.99	-8.60
U.S. government related	3.71	60[3]	5.54	0.12	-0.61	-8.23
U.S. corporate investment grade	4.43	132[3]	7.69	0.60	-0.29	-11.87
U.S. mortgage-backed securities	3.55	28[3]	5.54	0.44	-0.98	-6.77
U.S. commercial mortgage-backed securities	4.05	102[3]	4.83	0.19	-0.95	-7.50
U.S. asset-backed securities	4.02	79[3]	2.21	0.02	-0.53	-3.82
Preferred securities	5.70	204[3]	4.72	0.21	1.09	-8.34
High yield 2% issuer capped	7.44	410[3]	3.94	0.95	1.61	-7.66
Senior loans[4]	8.68	538	0.25	1.17	1.94	-0.78
Global emerging markets	6.69	359[3]	6.49	1.06	1.44	-14.18
Global aggregate (unhedged)	2.74	51[3]	7.06	0.42	-0.46	-12.49

1 Yield difference between the Bloomberg High Yield Municipal Index and the 20-year AAA MMD scale. **2** Data is a subset of the S&P Short Duration Municipal Yield Index that is below investment grade/nonrated. Spread is the yield difference between this subset and the subset rated AAA. **3** Option-adjusted spread to Treasuries. **4** Spread refers to the 3-year discount margin. Duration is estimated based on the frequency of the reset date.

Source: Bloomberg L.P. and Credit Suisse, 12 Aug 2022. **Past performance does not predict or guarantee future results.** Unless otherwise noted, the index is Bloomberg. All index returns are shown in U.S. dollars. **Yield to worst** is the lowest potential yield that can be received on a bond without the issuer actually defaulting. **Effective duration** (expressed in years) measures the price sensitivity of a fixed-income investment to a change in interest rates, considering that expected cash flows will fluctuate as interest rates change. Index performance is shown for illustrative purposes only. Index returns include reinvestment of income and do not reflect investment advisory and other fees that would reduce performance in an actual client account.

For more information, please visit nuveen.com.

Performance: Bloomberg, L.P. **Issuance:** The Bond Buyer, 12 Aug 2022. **Fund flows:** Lipper. **New deals:** Market Insight, MMA Research, 10 Aug 2022.

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Representative indexes: municipal: Bloomberg Municipal Index; **high yield municipal:** Bloomberg High Yield Municipal Index; **short duration high yield municipal:** S&P Short Duration Municipal Yield Index; **taxable municipal:** Bloomberg Taxable Municipal Bond Index; **U.S. aggregate bond:** Bloomberg U.S. Aggregate Bond Index; **U.S. Treasury:** Bloomberg U.S. Treasury Index; **U.S. government related:** Bloomberg U.S. Government-Related Index; **U.S. corporate investment grade:** Bloomberg U.S. Corporate Index; **U.S. mortgage-backed securities;** Bloomberg U.S. Mortgage-Backed Securities Index; **U.S. commercial mortgage-backed securities:** Bloomberg CMBS ERISA-Eligible Index; **U.S. asset-backed securities:** Bloomberg Asset-Backed Securities Index; **preferred securities:** ICE BofA U.S. All Capital Securities Index; **high yield 2% issuer capped:** Bloomberg High Yield 2% Issuer Capped Index; **senior loans:** Credit Suisse Leveraged Loan Index; **global emerging markets:** Bloomberg Emerging Market USD Aggregate Index; **global aggregate:** Bloomberg Global Aggregate Unhedged Index.

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Investing involves risk; principal loss is possible. Debt or fixed income securities are subject to market risk, credit risk, interest rate risk, call risk, derivatives risk, dollar roll transaction risk and income risk. As interest rates rise, bond prices fall. Below investment grade or high yield debt securities are subject to liquidity risk and heightened credit risk. Preferred securities are subordinated to bonds and other debt instruments in a company's capital structure and therefore are subject to greater credit risk. Foreign investments involve additional risks, including currency fluctuation, political and economic instability, lack of liquidity and differing legal and accounting standards. Asset-backed and mortgage-backed securities are subject to additional risks such as prepayment risk, liquidity risk, default risk and adverse economic developments. The value of convertible securities may decline in response to such factors as rising interest rates and fluctuations in the market price of the underlying securities. Senior loans are subject to loan settlement risk due to the lack of established settlement standards or remedies for failure to settle. These investments are subject to credit risk and potentially limited liquidity, as well as interest rate risk, currency risk, prepayment and extension risk, and inflation risk

Investors should contact a tax professional regarding the appropriateness of tax-exempt investments in their portfolio. If sold prior to maturity, municipal securities are subject to gain/losses based on the level of interest rates, market conditions and the credit quality of the issuer. Income may be subject to the alternative minimum tax (AMT) and/or state and local taxes, based on the state of residence. Income from municipal bonds held by a portfolio could be declared taxable because of unfavorable changes in tax laws, adverse interpretations by the Internal Revenue Service or state tax authorities, or noncompliant conduct of a bond issuer. It is important to review your investment objectives, risk tolerance and liquidity needs before choosing an investment style or manager.

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